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In the

SUPREME COURT OF THE UNITED STATES

October Term, 1973

No. 73-1789

MR. STEAK, INC.
and
THE CENTRAL BANK AND TRUST COMPANY
Petitioners,

versus

EDINA STATE BANK,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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June, 1974

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Mr. Steak, Inc., ("Mr. Steak"), and The Central Bank and Trust Company, ("Central Bank"), respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Tenth Circuit entered in these proceedings on September 14, 1973, in which a rehearing was denied on January 7, 1974.

OPINIONS BELOW

The opinion of the Tenth Circuit Court of Appeals, which reversed the judgment of the Federal District Court for the District of Colorado, is reported at 487 F.2d 640, and a copy thereof is appended hereto as Appendix A. The

order of the Federal District Court for the District of Colorado, making findings of fact and conclusions of law, and granting a judgment of dismissal in favor of Mr. Steak and Central Bank, dated February 7, 1972, is unreported, and a copy thereof is appended hereto as Appendix B.

JURISDICTION

The date of the judgment sought to be reviewed and the date of its entry is September 14, 1973. An order denying the rehearing was entered on January 7, 1974. This Court's jurisdiction is invoked under Section 1254(1) of Title 28 of the United States Code.

QUESTION PRESENTED

The question presented is:

Whether or not an issuer of securities (whose share certificates were not marked with a restrictive legend) and its transfer agent should be required to elect between:

(1) Transferring unregistered shares of stock and thereby violating §5 of the Securities Act of 1933, as amended [15 U.S.C. §77e], or, alternatively;

(2) Refusing transfer in order to comply with federal securities laws and thereby be subjected to a suit for damages under Article 8-204 of the Uniform Commercial Code.

STATUTORY PROVISIONS INVOLVED

This action involves the Securities Act of 1933, as amended, and the Uniform Commercial Code, as adopted in all 50 states and the District of Columbia.

Section 5 of the Securities Act of 1933, as amended, [15 U.S.C. §77e] sets forth the prohibitions relating to interstate commerce and the mails as follows:

"(a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

"(b) It shall be unlawful for any person, directly or indirectly —

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.

"(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registra-

> tion statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8."

Sections 4(1) and (2) of the Securities Act of 1933, as amended, [15 U.S.C. §77d(1) (2)] sets forth exempted transactions, as follows:

> "The provisions of section 5 shall not apply to —
>
> (1) transactions by any person other than an issuer, underwriter, or dealer.
>
> (2) transactions by an issuer not involving any public offering."

Section 14 of the Securities Act of 1933, as amended, [15 U.S.C. §77n] sets forth the public policy of the Act, as follows:

> "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void."

Article 8-204 of the Uniform Commercial Code, sets forth the effect of certain restrictions on transfer:

> "Unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it."

Official Comment 3 to Article 8-204 of the Uniform Commercial Code, is appended hereto as Appendix C, at page xxi.

STATEMENT OF THE CASE

Edina State Bank, ("Edina"), organized under the laws of the State of Minnesota, commenced this action to recover damages from Mr. Steak and Central Bank, the

issuer and transfer agent, respectively, both organized under the laws of the State of Colorado, for failure to transfer certain shares of common stock of Mr. Steak issued on or about January, 1969 to one Robert H. Price ("Price"), a former employee of Mr. Steak.

On or about July 11, 1968, Mr. Steak issued to Price 200 shares of its no par value common stock. Price was advised by Mr. Steak that said shares were restricted and were issued for investment purposes only and not for subsequent redistribution. At the time of the issuance of the aforesaid shares, and until on or about April 22, 1969, no shares of Mr. Steak had ever been registered with the Securities and Exchange Commission under the provisions of §5 of the Securities Act of 1933, as amended, [15 U.S.C. §77e]. The shares of Mr. Steak were not traded on any exchanges or on the over-the-counter markets. Mr. Steak was simply a privately held corporation.

In January, 1969, Mr. Steak split its stock on the basis of 12 additional shares for each share outstanding. In accordance therewith Price was issued an additional 2,400 shares of Mr. Steak, without any further consideration being paid. These shares, like the previous 200 shares, were issued for investment, and not for subsequent redistribution. Price was so advised. Mr. Steak was still at that time a privately held corporation. It is these 2,400 shares that form the subject matter of this litigation.

On or about March 5, 1969, Edina, through its President, made a loan to Price in the amount of $15,000, which loan was secured by the 2,400 shares of Mr. Steak. At the time of said loan Edina knew that Price was a former employee of Mr. Steak, that Mr. Steak was a privately held company, that its shares were not effectively registered with the Securities and Exchange Commission, and that no market for its stock existed. Edina failed to make any inquiry of brokers, the Securities and Exchange Commission or Mr. Steak as to the free transferability of said shares, or even

whether the 2,400 shares in question would be included in a Registration Statement covering certain Mr. Steak shares, which would subsequently become effective on April 22, 1969.

On April 22, 1969, a Registration Statement became effective with the Securities and Exchange Commission covering 300,000 shares of the Mr. Steak authorized but unissued shares for public sale. The aforesaid Registration Statement did not include any of the shares owned by Price, nor any other existing shareholder. Further, on April 24, 1969, Mr. Steak mailed a letter to 60 of its shareholders, including Price, informing them that the Mr. Steak shares owned or held by them were restricted and were not transferable without either an opinion of counsel or through the "no-action" procedure adopted by the Securities and Exchange Commission.* Price did not testify at the trial. Therefore, neither the receipt of this letter nor of the oral statements concerning the restrictions on the shares were in dispute and were admitted without issue.

Thereafter, until May 5, 1969, Edina made additional loans to Price, the total of which aggregated $27,000, secured by the same 2,400 shares of Mr. Steak stock. No further inquiry was made as to the free transferability of the shares, and no other collateral or security was obtained for the loans.

To secure its position, and after default on the loans by Price, Edina, on or about June 3, 1969 sold into the public markets through a broker-dealer, 1,000 shares of the 2,400 shares of Mr. Steak held as collateral for the Price loans, and received proceeds of approximately $37,000.

---

*A long well-recognized procedure whereby the staff of the Securities and Exchange Commission write opinions as to whether they will or will not recommend action based on certain facts presented by potential sellers of securities. In effect, an opinion as to the legality of certain proposed stock transactions.

Edina credited $27,000 to the note and returned the $10,000 excess to Price. When the shares were submitted for transfer to Central Bank, the transfer was refused and Central Bank advised Edina, on or about June 11, 1969, that the shares could not be transferred without an opinion of counsel, concerning the legality thereof. Edina has, to date, failed and refused to furnish its counsel's opinion, as repeatedly requested by Mr. Steak, that the Price shares could be sold publicly without registration. Further, Edina has never, to date, requested the Securities and Exchange Commission for relief from the registration requirements of the Securities Act of 1933, as amended, in accordance with the "no action" procedure.

When the transfer was refused, Edina, unilaterally, and without consulting either Mr. Steak, Central Bank, or Price, remitted $37,000 to the broker-dealer, obtained a new note from Price in this amount, which note was also secured by the same 2,400 shares of Mr. Steak stock. At the time of the execution of this new $37,000 note (which note forms the basis of this litigation) Edina had actual knowledge that the 2,400 shares of Mr. Steak were restricted and could not be publicly sold without either registration with the Securities and Exchange Commission, the opinion of its counsel or relief from such registration by the Securities and Exchange Commission. Price also had notice of the restriction on the shares prior to the time he borrowed any funds from Edina. Price did not appear to testify at the trial and no dispute of his knowledge of the restriction on his shares was raised. Further, Edina did not comply, even to this date, with any of the alternatives available to them to ameliorate this problem.

The 2,400 shares of Mr. Steak were issued to Price on or about January 31, 1969, and his initial transaction giving rise to the pledge occurred, on or about March 5, 1969, some five weeks thereafter. The sale of the unregistered stock in June, 1969 by Edina into the public markets,

occurred less than six month after the initial issue to Price. Subsequent to that time a drop in the market price of the Mr. Steak shares occurred. No action was ever taken by either Edina or its counsel from June, 1969 until April, 1970, when this action was commenced.

After a full trial on the merits, the United States District Court for the District of Colorado held for Mr. Steak and Central Bank, but its decision was subsequently reversed and remanded by the Court of Appeals for the Tenth Circuit. It is from this reversal by the Tenth Circuit that Certiorari is sought.

REASONS FOR GRANTING THE WRIT

The decision of the United States Court of Appeals for the Tenth Circuit should be reversed under Rule 19 of this Court.

The questions raised by this Petition, which have not heretofore been specifically determined by this Court, are of such vital importance to the free flow of securities in the equity markets as to require this Court to assume jurisdiction and settle the issue once and for all.

Section 5 of the Securities Act of 1933, as amended, [15 U.S.C. §77e], requires that a Registration Statement be in effect with the Securities and Exchange Commission, before a security can be sold by any person through the means and instrumentalities of interstate commerce or through the United States mails. Sections 4 (1) and (2) of the Securities Act of 1933, as amended, [15 U.S.C. § 77d (1) and (2)], exempts from registration both transactions "by any person other than an issuer, underwriter or dealer" and "transactions by an issuer not involving any public offering."

The Mr. Steak shares which are the subject matter of this action, were issued to Price in January, 1969 with-

out registration in reliance upon the exemption set forth in Section 4 (2), as a transaction by an issuer not involving any public offering.

Requisite to the availability of the aforesaid exemption from registration is the issuance of stock to a person, and in this case to Price, who acquires the shares for investment purposes only and without a view to subsequent redistribution. 1 Loss, *Securities Regulation* p. 653 et seq. Shares so issued are deemed "restricted", whether or not the certificate contains a "restrictive" legend. There is no federal requirement for marking such a legend on the certificates.

When the Price shares, held as collateral by Edina, were submitted for transfer, Central Bank, having been advised that the shares were "restricted," was faced with the following dilemma:

(1) should they transfer the Mr. Steak shares in violation of Section 5 of the Securities Act of 1933, as amended, and thereby subject themselves to injunctive or criminal sanctions; or

(2) should they rightfully refuse to register the transfer, avoiding liability under the Securities Act of 1933, as amended, but thereby face a suit for damages under Article 8-204 of the Uniform Commercial Code.

Indeed, not a very happy prospect for either an issuer or its transfer agent.

Mr. Steak and Central Bank respectfully submit that transfer agents and their issuers should not be subjected to such a devastating choice.

Article 8-204 of the Uniform Commercial Code states:

> "Unless noted conspicuously on the security a restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it."

Official Comment 3 to Article 8-204 (Appendix C) negates the impact of that section by stating:

> ". . . where notation of the restriction on all affected certificates may not be practical the issuer enforces it by notifying the holders of such certificates. . ."

An excellent discussion and critique of Article 8-204 is found in Israels and Guttman, *Modern Securities Transfers,* ¶6.07 (rev. ed. 1971) where:

> ". . . it is suggested that current commercial practice casts some doubt on the appropriateness of the conspicuous notice requirement of Section 8-204 of the Code."

The case before the Court exemplifies an instance of impracticality. Similarly situated are several thousand small companies, like Mr. Steak, whose shares are routinely "restricted" when issued. However, it should be emphasized that in compliance with Official Comment 3 above, Mr. Steak both orally and by letter informed Price that his shares were restricted and that they were issued for investment purposes only and not for resale. Thus, Price had both oral and written notice prior to the June 3, 1969 sale of the Mr. Steak shares into the public markets and prior to the execution of the $37,000 note which forms the basis of this action. In addition it should be noted that most small private companies, like Mr. Steak, do not utilize the services of a transfer agent prior to a public offering of its shares.

While Mr. Steak and Central Bank do not contend that any conflict exists between the Securities Act of 1933, as amended, and the Uniform Commercial Code, it is respectfully submitted that if this Court concludes that a conflict does exist, the federal law should prevail. This essentially was the rationale of the District Court in concluding that Mr. Steak and Central Bank should not be liable for damages under the facts herein. The basis for pre-emption is grounded in Section 14 of the Securities Act of 1933, as

amended. The public policy of the Securities Act of 1933, as amended, cannot be waived. Section 14 thereunder, [15 U.S.C. §77n] provides:

> "Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void.

See also *Kaiser-Frazer Corp. v. Otis & Co.,* 195 F.2d 838, 843 (2d Cir. 1952).

The Court of Appeals in rendering its decision, erroneously interpreted the policy of the Securities Act of 1933, as amended, by totally ignoring the argument of Mr. Steak and Central Bank that the federal law prohibits transfer of unregistered securities. Both Mr. Steak and Central Bank may well have been charged as aiders and abettors to a violation of the Securities Act of 1933, as amended, as in *Security and Exchange Commission v. Guild Films Co.,* 279 F.2d 485 (2d Cir.) cert. denied 364 U.S. 819 (1960). They complied with federal law and thus were entitled to refuse transfer of the shares in question. Such transfer would clearly be violative of federal securities laws. See also *In the matter of Skiatron Electronics and Television Corp.,* 40 SEC 236 (1960) '57-'61 CCH ¶76,719 where public distribution by pledgees of unregistered shares were held in violation of Section 5 of the Securities Act of 1933, as amended. See also *Branerton Corporation v. United States Corporation Co.,* 309 N.Y.S. 2d 28 (N.Y. Sup. Ct. 1970), where the liability of a transfer agent for refusal to transfer certain restricted securities was not summarily judged since a question existed as to whether the transfer agent reasonably believed that the transfer was forbidden by law.

It is impressed upon this Court to decide whether both the Securities Act of 1933, as amended and the Uniform Commercial Code can peacefully co-exist, side by side. It

is abundantly clear from the facts of this case that for a transfer agent to comply with both statutes may be virtually impossible.

The wide spread effect of the Court of Appeals' decision will certainly be felt by transfer agents and issuers who may be subjected to a suit for damages for failure to make a wrongful transfer. Alternatively, they place themselves in jeopardy of violating §5 of the Securities Act of 1933, as amended. The holding of the Tenth Circuit Court clearly disrupts the orderly administration of the security transfer process and is an encroachment on the public policy enunciated by Congress many years ago in adopting the Securities Act of 1933, as amended.

For authorities justifying assumption of jurisdiction of the United States Supreme Court, relating to cases involving a potential conflict between federal and state statutes, see the following:

> *Perez v. Campbell,* 402 U.S. 637, 91 S.Ct. 1704, 29 L.Ed.2d 233 (1971);
>
> *Hamm v. City of Rock Hill,* 379 U.S. 306, 85 S. Ct. 384, 13 L.Ed.2d 300 (1964) rehearing denied *Lupper v. Arkansas,* 379 U.S. 995, 85 S.Ct. 698, 13 L.Ed.2d 614;
>
> *Free v. Bland,* 369 U.S. 663, 82 S.Ct. 1089, 8 L.Ed.2d 180 (1962);
>
> *Gibbons vs. Ogden,* 9 Wheat. 1, 210- 211, 6 L.Ed. 23 (1824).

CONCLUSION

There is a singular lack of authority in this area of the law. It is vital that the issues be decided by this Court so that the many thousands upon thousands of security transfers that occur from day to day continue unencumbered by the dilemma posed by the decision of the Tenth Circuit.

This case and its issues present a new and novel question to the Court, one involving serious questions of conflict between state and federal law which should be considered by the Court in its role of establishing the supreme law of the land. Thus the petition for certiorari should be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

Three true and correct copies of this petition for writ of certiorari have this 29th day of May, 1974 been mailed, postage prepaid, to:

Mr. E. John Abdo, Esq.
1020 Dain Tower
Minneapolis, Minnesota 55402 Air Mail

Mr. Howard K. Phillips, Clerk
United States Court of Appeals for
the Tenth Circuit
Denver, Colorado

/s/ SANFORD B. HERTZ

SANFORD B. HERTZ, P.C.

[APPENDIX A]

UNITED STATES COURT OF APPEALS,
TENTH CIRCUIT

No. 72-1291.

Argued and Submitted Sept. 20, 1972.

Decided Sept. 14, 1973.

EDINA STATE BANK, Plaintiff-Appellant,

v.

MR. STEAK, INC., and Central Bank and Trust Company, Defendants-Appellees.

As Amended on Denial of Rehearing and Rehearing En Banc Jan. 7, 1974.

E. John Abdo, Minneapolis, Minn. (Benjamin E. Sweet, Denver, Colo., on the brief), for plaintiff-appellant.

Sanford B. Hertz, Denver, Colo. (Robert W. Hite, Denver, Colo., on the brief), for defendants-appellees.

Before PHILLIPS, SETH and HOLLOWAY, Circuit Judges.

HOLLOWAY, Circuit Judge.

[APPENDIX A]

Appellant Edina State Bank (the bank) sued Mr. Steak, Inc. (Mr. Steak) as the corporate issuer of stock and its transfer agent, Central State Bank and Trust Co. (Central), for damages for refusal to register transfer of pledged shares of Mr. Steak stock which the bank attempted to sell under its rights as pledgee. Central refused to register the transfer due to advice by Mr. Steak that the shares had been purchased for investment purposes and without a view to redistribution. Mr. Steak also had instructed Central that no transfer could be made without notice to it and an opinion of counsel that the transfer would not violate the Securities Act of 1933 (the Act). No legend of any restriction on transfer appeared on the Mr. Steak certificates and the bank had been advised by Price, the pledgor, when it made the loans that there were no restrictions.

The bank relies on the provision of § 8-204 of the Uniform Commercial Code that a restriction on transfer imposed by the issuer is ineffective unless conspicuously noted on the security, except against a person with actual knowledge of the restriction. The trial court found that the bank relied on Price's statement that there was no restriction and thereby suffered the loss. In ruling against the bank the court concluded that the Securities Act pre-empted the field and governed instead of the Code provisions; that the federal act required no legend as to the restriction; that also as between the bank and Mr. Steak as innocent parties, a duty of inquiry should be imposed on the bank because it knew of Price's recent employment by Mr. Steak; and that such inquiry to Mr. Steak was not made by the bank. The trial court denied recovery for the bank's loss. We are unable to agree.

First, we turn to § 8-204 of the Uniform Commercial Code which we feel supports the bank's right to recover damages for its loss since Mr. Steak as issuer failed to note any restriction on the certificates

and the bank had no actual knowledge of a restriction.[1]

The facts as they apply under the statute are mostly without dispute. In July, 1968, Mr. Steak issued 200 shares of its no par common stock to Price who was its employee. At that time and until April, 1969, no Mr. Steak shares had been registered with the Securities and Exchange Commission under § 5 of the Act, 15 U.S.C.A. § 77e. The shares involved in this suit were never registered. In July, 1969, a stock split occurred and Price was issued an additional 2400 shares. Neither certificate had any notation of any restrictive legend. Mr. Steak did not request an investment letter from Price when either certificate was issued. However, the trial court found that the stock was received by Price with knowledge it was restricted and being received for investment purposes only as an exemption stock. See 15 U.S.C.A. § 77d(2). The trial court concluded that since the issuer, Mr. Steak, had made this clear to Price, it had fulfilled its obligation to Price and the public.

The loan transactions with the bank that followed present the aspect of this case bringing § 8-204 of the Code into play. On March 5, 1969, the bank made a loan to Price of $15,000 which was secured by a pledge of Price's 2400 shares of Mr. Steak stock. The trial court's findings accepted the bank President's testimony that he inquired of Price whether there was any restriction and that Price said it was not restricted. The trial court found that the bank relied on Price's statement and referred to the

[1] No question is raised as to applicable law and both parties cite § 8-204 and other portions of the Code which has been adopted in both Colorado and Minnesota, respectively the place of incorporation and principal place of business of Mr. Steak; and the place of incorporation, principal place of business and site of the loan transactions of the bank. See 7A C.R.S.1963 § 155-8-204 and 21C Minn.Stat.Ann. § 336.8-204. Under the Code provisions the law of Colorado, the jurisdiction of organization of the corporation whose stock is involved, governs. U.C.C. § 8-106.

bank as an innocent party, as it also described Mr. Steak.

In April, 1969, Price executed another note for a $6,600 loan, secured by the same stock. Again on May 5, 1969, Price obtained an additional $5,155.60 loan from the bank and it consolidated the loans and Price signed a note for $27,000, secured by the same stock. Price later defaulted in payment of the loans.

On about June 3, 1969, the bank, attempting to secure its position, submitted 1,000 shares to a broker for sale for its account.[2] The brokerage house made two 500-share sales. The proceeds of $36,739.34 received by the bank were credited to Price's checking account, and the account was debited for $27,000 to pay the loans. Price used the balance in his restaurant business.

However, when the brokerage house requested registration of transfer to the purchaser, the transfer agent refused. Central said that Mr. Steak had advised it that the shares were purchased for investment and without a view to redistribution and that no transfer of the shares could be made without notice to Mr. Steak or its counsel and without an opinion of counsel that the transfer would not violate the Securities Act. Since the sale was forestalled the bank repaid the brokerage house in full and called on Price for the funds, which he could not repay. The bank then obtained a new note from Price for $37,000 to cover all the funds advanced to Price, again secured by the stock which the bank of course then knew was restricted.

§ 8-204 of the Code provides:

"Unless conspicuously noted on the security, a

[2] No issue has been raised as to the right of the bank to proceed as it apparently did before maturity of the $27,000 note, except the objections based on the restriction on transfer discussed in this opinion. See U.C.C. § 9-207(1) and (4) as to the rights of the pledgee respecting the collateral.

restriction on transfer imposed by the issuer even though otherwise lawful is ineffective except against a person with actual knowledge of it."

The comments on this section of the Code emphasize that it imposes a strict requirement for notice on the issuer. See Official Comment 1, 7A C.R.S.1963, § 155-8-204. This duty is similar to that imposed by § 15 of the Uniform Stock Transfer Act.[3] Since there was no legend conspicuously noting the restriction on transfer and no actual knowledge of it by the bank, we are persuaded the bank is entitled to recover under § 8-204 of the Code, as the court was under the similar provision of the Uniform Stock Transfer Act in Prudential Petroleum Corp. v. Rauscher, Pierce & Co., 281 S.W.2d 457 (Tex.Civ.App.) (ref.n.r.e.). See also General Development Corp. v. Catlin, 139 So.2d 901, 902 (Fla.App.); Haas v. Haas, 35 Del.Ch. 392, 119 A.2d 358.[4]

[3] The Uniform Stock Transfer Act made unnoted restrictions invalid without the exception as to persons having actual knowledge of them.

[4] As commentators have noted, Article 8 of the Uniform Commercial Code reveals a clear intent on the part of the draftsmen to confer "full negotiability" upon investment securities. See, e.g., Folk, Article Eight: A Premise and Three Problems, 65 Mich.L. Rev. 1379 (1967); Israels, Investment Securities As Negotiable Paper—Article 8 of the Uniform Commercial Code, 13 Bus.Law. 676, 677-78 (1958); Stop Transfer Procedures And The Securities Act of 1933—Addendum to the Uniform Commercial Code—Article 8, 17 Rutgers L.Rev. 158 (1962); Lee, Impact of the Uniform Commercial Code on Colorado Law, 42 Den.L.J. 67, 101 (1965); Wickersham, Investment Securities under the Uniform Commercial Code, 1 B.C.Indust. and Comm.L.Rev., 37, 38; Comment, The Status of an Investment Security Holder, 33 Ford.L. Rev. 466, 467, 482 (1965). See also, Guttman, Article 8—Investment Securities, 17 Rutgers L.Rev. 158 (1962). And with respect to U.C.C. § 8-104, another commentator has observed that the Code "is consistent with a general modern trend which prevents corporations from taking advantage of their own lack of authority in their dealings with parties who are outside the internal framework of the organization." Carrington, Banking, Commercial Paper and Investment Securities Under the Uniform Commercial Code, 14 Wyo.L.J. 198, 217 (1960).

[APPENDIX A]

[1] As noted the trial court concluded that since both the bank and Mr. Steak were innocent parties, it was proper to impose more of a duty to inquire than the bank undertook. The Court's findings point out that no inquiry was made of Mr. Steak, although the bank inquired of Price and was found to have relied on his representation that there was no restriction. Appellees also point to admissions by the bank President that he made no inquiry of the Commission or of any brokers; that he knew that the stock was privately held and had no market and was "going to go public;" and that he did not know whether the Price shares were to be included in the registration statement. They say the record establishes a lack of due diligence. However, we think the Code provision in § 8-204 applies and that it clearly placed the duty on Mr. Steak as issuer to note the restriction conspicuously on the certificate, not on the bank to inquire. And the statute's protection was extended to all against an unnoted restriction except those with "actual knowledge of it." Those who are only on inquiry notice are not denied protection by the Code.

The trial court's view was that since the restriction had been made clear to Price, Mr. Steak had fulfilled its obligation to him and the public. We are convinced, however, that § 8-204 required more—that the issuer conspicuously note the restriction on the certificate for the protection of others. The bank as pledgee was among the persons protected generally by § 8-204 against a restriction not conspicuously noted on the security, except as to a person with actual knowledge. The wrongful refusal to transfer gave rise to a right to sue as for conversion by the bank as transferor. See Holly Sugar Corp. v. Wilson, 101 Colo. 511, 75 P.2d 149; Official Comment 1 to § 8-204; see also Case v. Citizen's Bank of Louisiana, 100 U.S. 446, 25 L.Ed. 695; Annotation, Remedy for refusal to transfer stock, 22 A.L.R.

[APPENDIX A]

2d 12, 34. We conclude that under the facts as found and shown by this record, the state law in § 8-204 of the Code supports the bank's right to recover against the issuer which failed to comply with the strict requirement of the statute.

Second, we consider the trial court's views concerning the Securities Act and arguments of Mr. Steak and Central related to them. The court concluded that the federal statute preempted the field and that to the extent there is any conflict between it and the Code, the federal Act will prevail. And the court held that Congress had not required a legend on the certificate as to restrictions on transfer so that its absence did not make the appellees liable for refusal to register the transfer.

The Securities Act of 1933, as amended, 15 U.S.C.A. § 77a et seq., does not impose a requirement for such a legend. It is recognized by the Commission's Releases Nos. 33-5121, 17 C.F.R. §§ 231.5121 and 33-5223, 17 C.F.R. § 231.5226, that the presence or absence of an appropriate legend will be regarded as a factor in considering whether the circumstances surrounding the offering are consistent with the exemption for a non-public offering. Section 4(2) of the Act, 15 U.S.C.A. § 77d(2). The use of the legend was urged in the Releases, but is not required by the statute or regulations.

[2] We cannot agree that the absence of a requirement for a notation of the restriction in the federal statute overrides § 8-204 under the doctrine of preemption. As further discussed below we feel that this important provision of the Code may be read in harmony with the federal statute.[5] Both regulations can be enforced without impairing federal superintendence of the field and thus the state statute

[5] As later discussed, since only damages for the loss to the bank are being sought, no question arises as to whether carrying out the sale of the pledged securities would violate the Securities Act.

need not give way. Florida-Avocado Growers v. Paul, 373 U.S. 132, 142, 83 S.Ct. 1210, 10 L.Ed.2d 248; Huron Cement Co. v. Detroit, 362 U.S. 440, 446, 80 S.Ct. 813, 4 L.Ed.2d 852. We feel the Securities Act shows no intent to prevent such significant regulation by state law. See New York Dept. of Social Services v. Dublino, 413 U.S. 405, 417, 93 S.Ct. 2507, 2515, 37 L.Ed.2d 688 (Slip Opinion p. 8) (6/21/73). Congress itself adopted the Code provision in § 8-204 for the District of Columbia some time after its enactment of the Securities Act. See D.C.Code, §§ 28:8-101, 28:8-204 (1967 ed.), 77 Stat. 732, 735. We are satisfied the federal statute should not be held to override § 8-204.

The appellees argue that the federal prohibitions against transfer of unregistered stock required and entitled them to refuse to register the transfer here, relying on Securities and Exchange Commission v. Guild Films Co., 279 F.2d 485 (2d Cir.), cert. denied, 364 U.S. 819, 81 S.Ct. 52, 5 L.Ed.2d 49, and similar cases. The argument is that if the transfer had been made, appellees might well have been charged as aiders and abettors to a violation of the Securities Act themselves. Thus they say the federal statute is a valid defense against liability for damages for refusal to register the transfer of the stock involved here.

[3] We find no ground for defense to the damage claim in this theory. If the sale of the pledged shares would violate the federal statute, perhaps it could be enjoined by the Commission as in SEC v. Guild Films Co., supra, but we need not reach this question. In any event we think that the prohibition of the federal statute against carrying out certain transfers does not defeat the bank's right to damages under § 8-204 of the Code. We need not decide whether the bank here as a bona fide pledgee could enforce specifically the transfer of the collateral to the purchaser. We have only the question whether the bank is entitled to

damages when the issuer asserts its own restriction which was not conspicuously noted on its stock certificate as a ground for refusing to register a transfer. We are persuaded that in these circumstances the bank is entitled to damages for its loss and that the recovery of them is not violative of the federal prohibition against transfer. See Prudential Petroleum Corp. v. Rauscher, Pierce & Co., 281 S.W.2d 457 (Tex.Civ.App.) (ref. n. r. e.). The possible unavailability of one remedy need not defeat the injured party's right to another.

Third, we consider appellees' argument that they followed the provisions of § 8-401 of the Code in refusing to register transfer of the stock and are, therefore, free from liability. The theory is based on § 8-401(e), providing in substance that the issuer is under a duty to register a transfer if it is in fact "rightful" or to a bona fide purchaser. Appellees say that the transfer would not have been "rightful" under the Securities Act and that the bank cannot come within the definition of § 8-302 of a bona fide purchaser in view of its terms and the definition of notice in § 1-201(25).

[4] We need not determine whether the bank failed to come within these general provisions and definitions of the Code. The specific provisions of § 8-204 are controlling in our opinion, affording protection against a restriction not conspicuously noted on a certificate except as to a person with actual knowledge of it. And, as discussed earlier, the bank qualifies for this protection under § 8-204.

[5] Lastly appellees say that the judgment in their favor should be affirmed for failure of the bank to mitigate damages in any event. The contention is that during a period when the value of the stock continued to decline, the bank failed to furnish an opinion of counsel concerning the validity of transfer under an exemption from registra-

tion which would have permitted the transfer and avoided the loss.

We feel the argument is without merit. It is based on an alternative requiring an opinion of counsel to deal with legal questions raised by Mr. Steak's assertion of the restriction on transfer not noted on its certificate. This again involves reliance by Mr. Steak as issuer on its unnoted restriction which is made ineffective as to the bank by § 8-204. The bank is entitled to protection against the unnoted restriction by § 8-204 and this argument against recovery for the loss is untenable in view of the Code provision.

[6] The appellant asks that we direct the entry of judgment for its damages. The facts necessary for a judgment appear to be covered by the stipulation and proof in the record. However, in view of its ruling on liability the trial court did not reach the damages question or consider it under the applicable state law. We feel that the trial court should determine the proper recovery.

Accordingly the judgment is reversed and the case is remanded for further proceedings and entry of judgment which the trial court finds to be proper.

[APPENDIX B]

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLORADO

Civil Action No. C-2621

EDINA STATE BANK, Plaintiff,	)	REPORTER'S TRANSCRIPT
vs.	)	FINDINGS OF FACT AND
MR. STEAK, INC., Defendant.	)	CONCLUSIONS OF LAW

The above-entitled matter came on for hearing at the hour of 9:00 o'clock a.m., Monday, February 7, 1972, before the HONORABLE HATFIELD CHILSON, Judge presiding in Courtroom "C", United States Courthouse, Denver, Colorado.

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[APPENDIX B]

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[APPENDIX B]

PROCEEDINGS

THE COURT: Very well.

Gentlemen, what the Court will do in view of the fact that most of the basic and essential facts are contained in the Brief Statements of Facts and Uncontroverted Facts in the Pre-Trial Order, the Court is going to make its Findings of Fact and its Conclusions of Law in this case into the record rather than to take the Court's time to prepare written Findings of Fact and Conclusions of Law or to require counsel to go through that exercise because in this case it's — the Findings of Fact are not greatly important because they are not inconstrued in the basic or essential facts.

Mr. Abdo, in his Brief, made a rather succinct statement of the facts, and the Court will refer to that statement, not to the exclusion of the uncontroverted facts contained in the Pre-Trial Order, but merely by way of discussion.

The Court does adopt as a portion of its findings the uncontroverted facts set forth in the Pre-Trial Order.

Mr. Abdo, in his Memorandum Brief, in opposition to the Motion for Summary Judgment filed February 10, 1971, summarizes the facts as follows: — This may not be an exact quote in all instances, but it will be the substance — that on or about July 11, 1968, Robert Price, an employee of Mr. Steak, Incorporated, purchased two hundred shares of Mr. Steak, Incorporated, stock. At the time of the purchase, no attempt was made by the company to secure an investment letter, and I don't know what you mean by that, Mr. Abdo, obtain from whom?

MR. ABDO: From Mr. Price, in this instance, a letter which in substance would state that Mr. Price was taking these original issued shares —

[APPENDIX B]

THE COURT: That is what I thought you meant, and with that explanation the Court adopts this — to secure an investment letter nor was any notation placed on the certificate indicating the restrictions.

The Court will interline there one of the facts as to which there is no dispute that doesn't appear in Mr. Abdo's statement, and that is that the stock issued to Mr. Price was in fact issued by the company under its claim of exemption under Section 42 as being for investment and not for public distribution.

In returning now to Mr. Abdo's statement, in January, 1969, there was a stock split which resulted in Mr. Price's receiving 2400 additional shares, evidenced by Certificate No. 285. Mr. Price subsequently left his employment with Mr. Steak, Incorporated, to go in business for himself, and on March 5, 1969, Mr. Price executed a $15,000 demand note in favor of the Edina State Bank which was secured by the 2400 shares of Mr. Steak stock which was the additional issue made in January of '69. On April 7, 1969, Mr. Price executed another note in the amount of $6600, and on April 24, 1969, Mr. Price — no, on April 24, 1969, Mr. Steak mailed a letter to Mr. Price and some 59 other shareholders, indicating to them they had taken the stock for investment purposes.

It was next contained in Mr. Abdo's Statement of Facts, and I quote, "Mr. Price did not receive a copy of the letter."

There was no evidence to sustain that declaration. The evidence is to the contrary, and the Court draws the inference from the evidence that Mr. Price did receive a copy of the letter of which I believe is Exhibit "B".

On May 5, 1969, Mr. Price consolidated the previous two loans and obtained $5,155.60, making a total of

about $27,000.00 owing the bank. This note was executed for that purpose.

On or about June 3, 1969, the bank, attempting to secure its position, sent 1,000 shares of the stock it held as collateral to John Stevens and Company for the sale for its account. Five hundred shares were sold at $37,500 at thirty-seven and a quarter, and the bank received from the broker $36,000. The bank credited $27,000 to the note. The excess was paid to Mr. Price. Almost immediately after the sale the broker notified the bank that the sale was cancelled because the securities were "undeliverable," and the securities were returned to the bank. The refusal to transfer, although not so stated in Mr. Abdo's statement, resulted from the refusal of the transfer agent, Central Bank and Trust Company, to make the transfer because it had been notified also by the letter of April 24, 1969, Exhibit "B", that the stock issued to those some 60 shareholders was restricted and was not transferable without either an attorney's opinion or by a no action letter issued by the Securities and Exchange Commission. As a result, that is, of the transfer, the bank had to repay the money, and since it distributed certain amounts to Mr. Price, they had to dig up that money out of the bank's assets, and the bank took the note for $37,000. That, I think, is a fair summary made by Mr. Abdo of the essential facts in the case.

The Court must make it clear that under the evidence here there is no question, and the Court does find that Mr. Price knew at the time he began dealing with the Edina State Bank that his stock was restricted and that he didn't have and was not at liberty to dispose of it. At that time the stock had been issued, but, a very short time, and, now, Mr. Price discussed the matter of the stock with Mr. Karos, and Mr. Karos has testified in substance that he inquired of Mr. Price whether or not the stock was restricted and Mr. Price

stated that it was not restricted, that it was retrading stock, and the Court can infer from the evidence that Mr. Karos relied upon Mr. Price's statements, so we have a situation here, gentlemen, where by the wrongdoing and the misrepresentations of the third party, Mr. Price, the bank has suffered a loss.

Now, basically, the question of law involved here is whether or not it's the bank that is to suffer this loss or whether it is Mr. Steak and the transfer agent. The plaintiff contends that the issues presented in this case are governed by the Uniform Commercial Code. We may consider the Uniform Commercial Code in considering the disposition of this case, but insofar as the disposition of this case is governed by the Securities Act of 1933 as amended, the Federal Government has pre-empted the field and to the extent that there is a conflict between the Securities Act of 1933 and the application of the Uniform Commercial Code in the circumstances of this case, it is the Securities Act which will prevail and which the Court will consider.

The development of the law in this area is far from complete and the Court is not going to succomb to the temptation of attempting to say something or question something to solve many of the unsolved problems. The Court in this case is going to confine itself specifically to the facts of this case and upon the facts of this case the Court concludes as a matter of law that the judgment herein should be rendered in favor of the defendant and against the plaintiff. The 1933 Securities Act requires in most cases that issuances of stock be under a registration statement and there are some exemptions as to that. One of them is the exemption relied upon by the defendant, Mr. Steak, Incorporated, in this case, and whether or not that exemption is well taken, whether or not it could stand up under an attack by the Securities and Exchange Commission or could

stand up under attack by a purchaser of the stock from Mr. Steak is not in issue here. The stock was issued under that exemption. The stock was received by Mr. Price after full knowledge and notice that it was restricted and that he was receiving it for investment purposes only. This was made clear to him, and the reason for it was made clear to him, first orally and then by virtue of Exhibit "B", so there is no doubt that Mr. Price was adequately informed that Mr. Steak was issuing this as exemption stock and that he received it as such, and subject to the corresponding restrictions.

Having done that, in the Court's opinion, Mr. Steak had fulfilled its obligations, not only to Mr. Price, who acquired the stock, but also its obligations that it owed to the public.

There is no requirement of the law that an investment letter must issue and while we are on the matter of investment letter, in view of the misrepresentations and the concealment by Mr. Price, the Court fails to see what good it would have done for the company to have given Mr. Price a letter, investment letter, or vice versa, that Mr. Price give a letter to Mr. Steak, and knowing that this stock was restricted because he concealed that just as well as he concealed the oral statements, just as well as he could have concealed the letter of April 24, 1969.

As to the matter of the legend, the Court is no — is certainly no expert in the field, and why the Congress does not require the legend, I don't know, but it doesn't require the legend to be upon the stock, and so concisely that in and of itself does not make Mr. Steak or its agent, Central Bank and Trust Company, liable for failure to do something which the law requires.

Turning to one other aspect of how the Court has arrived at its conclusion that judgment should be in favor

of the defendant, is the matter of the conversations between Mr. Price and Mr. Karos, Mr. Karos at that time representing the bank. Mr. Karos obviously was alerted to the fact that all stock was not freely tradeable, so Mr. Price was not dealing with an unsophisticated person or institution. Mr. Karos was knowledgeable enough to ask about it, but he left the inquiry drop at that point after he was assured by Mr. Price that it was freetrading stock and not subject to restrictions.

In addition, Mr. Karos had the information that Mr. Steak had recently or that Mr. Price had recently been employed by Mr. Steak, and it would appear that as between the two innocent parties in this case, the bank on the one hand and Mr. Steak on the other, that we should have imposed or should impose upon the bank somewhat more of a duty to inquire than the bank undertook, an inquiry by Mr. Karos of Mr. Steak, which would have revealed the situation, and if it hadn't revealed the situation, and Mr. Steak had not given Mr. Karos the correct information, then we would have a different kettle of fish and we would probably have a different result. No such inquiry was made.

I think that the Court has said enough to advise a reviewing Court of the — of its Findings of Fact and its Conclusions of Law, and how it arrived at these conclusions, and if the Court has done that, it appears to the Court that the time and effort which would be involved in assigning to counsel the obligation of putting this in writing is justified as well as by using this procedure we expedite a review of this transaction, and that, in the Court's view, is a matter for consideration.

Is there anything further? We will have the Clerk of the Court prepare the usual form of judgment to be entered. The judgment will be judgment of dismissal in favor of the defendant for dismissal of the complaint and that

the defendants of judgment, for their costs to be taxed by the Clerk of the Court upon the filing of the bill of costs.

(WHEREUPON, this ended the statement of Findings of Fact and Conclusions of Law by the Court.)

[APPENDIX C]

STATUTORY MATERIAL

Investment Securities — Uniform Commercial Code — Official Comment 3 to Article 8-204

Prior Uniform Statutory Provision: Section 15, Uniform Stock Transfer Act.

3. Cooperative associations and ventures, as well as private clubs are generally considered an exception to the rules against restrictions on transfer as unreasonable restraints on alienation and are permitted for example to require the consents of governing bodies such as a board of directors. Penthouse Properties, Inc. v. 1158 Fifth Avenue, Inc., 256 App.Div. 685, 11 N.Y.S. 2d 417 (1939).

Historically restrictions on transfer were most commonly imposed by so-called "closely-held" issuers (including cooperatives and the like) in an attempt to restrict control if not total membership to a homogeneous security holder group. They are being increasingly resorted to today by issuers with publicly held securities seeking to police enforcement of the registration requirements of the Securities Act of 1933 against persons purchasing their securities in a transaction exempt from those requirements (e. g., one "not involving any public offering" [Securities Act of 1933, Section 4 (1)]) or against persons in a "control" relationship to the issuer. [Securities Act of 1933. Section 2 (11) and see Rule 405 of the Rules and Regulations of the Securities and Exchange Commission under that Act.] Particularly in the latter context where notation of the restriction on all affected certificates may not be practical the issuer enforces it by notifying the holders of such certificates and refusing requests to register transfer out of the name of the "controlling person" either for purposes of sale or for delivery after sale, relying on the stated exception as to a person "with actual knowledge" of the restriction. [Comment 3 was amended in 1962].

MOTION FILED
JUN 5 1974

IN THE

Supreme Court of the United States

October Term, 1973

No. 73-1789

MR. STEAK, INC., and
CENTRAL BANK AND TRUST COMPANY,
Petitioners,

v.

EDINA STATE BANK,
Respondent.

MOTION OF THE STOCK TRANSFER ASSOCIATION, INC., FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF OF THE STOCK TRANSFER ASSOCIATION, INC., AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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June 4, 1974

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MR. STEAK, INC., and
CENTRAL BANK AND TRUST COMPANY,
Petitioners,

v.

EDINA STATE BANK,
Respondent.

MOTION OF THE STOCK TRANSFER ASSOCIATION, INC., FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

The Stock Transfer Association, Inc. ("Association"), respectfully moves this Court for leave to file the accompanying brief as amicus curiae in this case. The attorneys for the Petitioners have given their consent to the filing of such brief, but the attorneys for the Respondent have refused to give such consent.

The nature of the Association's interest in this case is set forth in the accompanying brief.

The Association believes that the questions of law, in light of important policy concerns of the Securities Act of 1933, as amended, and equally important responsibilities of issuers and transfer agents of securities thereunder, are not adequately presented in the brief filed by the Petitioners in the United States Court of Appeals for the Tenth Circuit or in the Petition.

The Association believes that the views which it wishes to present to this Court will contribute to a proper resolution of such questions and to the ultimate public good. If such views should be adopted by this Court, the decision below must be reversed.

WHEREFORE, the Association respectfully requests leave to file the accompanying brief as amicus curiae.

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June 4, 1974

IN THE

Supreme Court of the United States

October Term, 1973

No. 73-1789

MR. STEAK, INC., and
CENTRAL BANK AND TRUST COMPANY,
Petitioners,

v.

EDINA STATE BANK,
Respondent.

BRIEF OF THE STOCK TRANSFER ASSOCIATION, INC., AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Interest of The Stock Transfer Association, Inc.

The Stock Transfer Association, Inc. ("Association"), is a sixty-year-old organization now existing as a corporation under the Not-For-Profit Corporation Law of the State of New York. Its members are individual representatives of (a) banks and trust companies and other organiza-

tions which act as independent, or professional, transfer agents, (b) corporate issuers which transfer their own securities and (c) other organizations involved, in one way or another, in the security transfer field. The Association has more than 400 regular members throughout the United States and Canada, is managed by an elected board of 18 directors and operates through a number of standing committees. In an advisory and educational capacity, the Association is dedicated to the development and improvement of the security transfer process. Over many years, it has developed rules for the transfer of securities which have brought about greater uniformity in the procedures of transfer agents and which have had considerable effect on expediting and simplifying the transfer of securities.

The Association holds an annual meeting during which there is intensive discussion for a three-day period of various matters of importance in the security transfer field. The Association also holds other regular meetings, and its Board of Directors and standing committees meet regularly, in both the United States and Canada.

The Association has a serious interest in a review by this Court of the decision of the United States Court of Appeals for the Tenth Circuit. This decision, if left undisturbed, will subject issuers and transfer agents throughout the United States and Canada to unreasonable responsibilities in similar cases and will perpetuate a nationwide lack of uniformity in what the Association strongly believes to be the proper approach to the questions involved.

Question Presented

In its broadest sense, the question presented by this case is whether the policy concerns embodied in Section 5 of the Securities Act of 1933, as amended ("Act"), 15 U.S.C. § 77e (1970), that "Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly ... in interstate commerce ... to sell such security ...." shall yield to considerations affecting private rights of individuals under state law.

Narrowly stated, such question is whether a failure on the part of an issuer to place on the certificates representing any "unregistered" securities under the Act a conspicuous notation to the effect that transfer of such securities is restricted by the Act should subject such issuer and its transfer agent to liability for damages under Section 8-401 of the Uniform Commercial Code for a refusal to register a transfer to a person without actual knowledge of such restriction.

Statement of the Case

This is an action brought by Edina State Bank ("Edina") against Mr. Steak, Inc. ("Mr. Steak"), and Mr. Steak's transfer agent, Central Bank and Trust Company ("Central"), for damages resulting from the alleged wrongful refusal of Mr. Steak and Central to register transfer, following a sale, of 1,000 shares of stock in Mr. Steak which Edina had accepted as part of a pledge of collateral for a series of loans made by Edina to Price, an

employee of Mr. Steak at the time of issuance. Initially, 200 shares, which were not registered under the Act, had been issued to Price, pursuant to the "private offering" exemption available to Mr. Steak under Section 4(2) of the Act, 15 U.S.C. § 77d(2) (1970). The stock pledged comprised 2400 shares representing a subsequent 12-for-1 stock dividend. The stock certificate evidencing the 2400 pledged shares bore no legend. Price had been advised at the time of issuance, and subsequently reminded, that the stock was "restricted" but told Edina at the time of the initial loan that the stock was not "restricted". Price was not able to discharge his indebtedness to Edina; and Edina sold, but was subsequently forced to rescind the sale of, 1,000 of the pledged shares. Rescission resulted from the refusal of Mr. Steak and Central to register the transfer without a "no action" letter from the Securities and Exchange Commission or an opinion of counsel that the transfer did not violate the Act.

In the District Court for the District of Colorado, Edina argued that, in accordance with Section 8-204 of the Uniform Commercial Code in effect in Colorado, Colo. Rev. Stat. ch. 155, § 155-8-204 (1963), any restriction on transfer, even a restriction imposed by reason of the Act, was ineffective because Edina did not have actual knowledge of the restriction. Mr. Steak and Central maintained that the prohibitions of the Act were an absolute bar to registration of the transfer. The factual arguments of the parties, which were made in the context of the foregoing opposing views, will be discussed in an amicus curiae brief on the merits, should the Petition be granted.

The District Court, finding a conflict between Section 8-204 and the prohibitions of the Act, which does not im-

pose on an issuer any requirement to place a restrictive legend on certificates representing securities issued pursuant to an exemption available under the Act, ruled in favor of Mr. Steak and Central on the ground that the rights and obligations of the parties were controlled by the Act, since the federal government had preempted the field.

The United States Court of Appeals for the Tenth Circuit reversed and remanded for further proceedings and judgment on the quantum of damages. It held that, since Edina had not requested injunctive relief compelling registration of the transfer, Section 8-204 "may be read in harmony with the [Act]" and that, in the circumstances of this case, the "strict requirement" of Section 8-204, namely, that the issuer note conspicuously on the certificate any restriction on transfer, supported Edina's right to recovery of damages under Section 8-401 by reason of Mr. Steak's and Central's refusal to register the transfer.

Reasons for Granting the Writ

The Association believes that the decision below raises a very serious question of federal law which should be settled by this Court. The Association shows in this brief that the decision, which places the private rights of individuals under the Uniform Commercial Code above the salutary purposes of the Act, imposes on issuers and transfer agents unreasonable responsibilities under the Act in connection with the flow of securities in the nation's marketplaces. The Association strongly believes that the merits of this case, particularly the issues involving the

respective duties of Edina, as pledgee, and Mr. Steak and Central, as issuer and transfer agent, respectively, deserve review by this Court.

A. This case presents a clear conflict between the purposes of the Securities Act of 1933 and the Uniform Commercial Code.

It is undeniable that a principal purpose of Article 8 of the Uniform Commercial Code is to confer "full negotiability" on investment securities, *see Edina State Bank v. Mr. Steak, Inc.*, 487 F.2d 640, 643 n.4 (10th Cir. 1973), and that that is the reason behind Section 8-204. It is also undeniable that impugning the title of a good faith purchaser of an investment security without knowledge is a serious matter. Nevertheless, the Association submits that the very considerable mandate of Section 5 of the Act that no security be sold in interstate commerce in the absence of an effective registration statement as to such security is of overriding national concern. Before such concern be made to bow to private rights of individuals under state law on the imposing authority of the decision below, the conflict should be reviewed by this Court.

The District Court in this case clearly saw the conflict between Section 8-204 of the Uniform Commercial Code and Section 5 of the Act. In resolving such conflict, the District Court determined that the Act must prevail. The Association strenuously supports such determination.

As noted by both the District Court and the court below, there is no substantive requirement under the Act that "unregistered" securities bear a restrictive legend. How-

ever, the Securities and Exchange Commission has stated that restrictive legends serve an important policing function and has indicated that the presence or absence of "an appropriate legend", together with the presence or absence of stop-transfer instructions issued to any transfer agent and a statement of the initial purchaser's investment intent, will be regarded "as a factor in considering whether the circumstances surrounding the offering are consistent with the exemption under Section 4(2) of the Act" [transactions by an issuer not involving any public offering], which "is essentially a question of fact". Sec. Act Rel. 5121, 36 Fed. Reg. 1525 (1970). *See also* Sec. Act Rel. 4552, 27 Fed. Reg. 11316 (1962). The Commission has emphasized the evidentiary nature of such a legend and the fact that the legend is not to be regarded as a basis for the exemption. *Id.*

While it would certainly be desirable that in every "private offering" situation securities taken "for investment" be legended, as a practical matter, legending is not always possible. For example, thousands of small private issuers are often unable to call in their privately held certificates for legending when they "go public"; and the most that such issuers can be expected to do is to remind their existing stockholders and their transfer agents that the outstanding stock is "restricted". These issuers, which can be found throughout the United States, must be permitted, with impunity, to refuse to register a transfer otherwise mandated under state law when the transfer, even to a purchaser without actual knowledge of any restriction, could subject them to penalties for violation of the Act and, in fact, directly vitiate the purposes of the

Act. The Association fails to find in Section 8-204, or any similar state statute, sufficient justification for a rule of law which can subject an issuer or its transfer agent to such penalties.

Perhaps more troublesome than the difficulties surrounding the unlegended "investment" security are the problems attendant upon the transfer of securities by "control" persons, or affiliates. It is well known that it is often impossible to legend certificates acquired by "control" persons; and an issuer or transfer agent may be implicated in a violation of the Act if required to register a transfer to a purchaser without knowledge of the "control" relationship. Again, the most that an issuer may be able to do in connection with securities held by "control" persons is to notify its known "control" persons and issue stop-transfer instructions to its transfer agent. *See* 1 L. Loss, *Securities Regulation* 2654 (2d ed. Supp. 1969) [hereinafter cited as *Loss*]; Israels, *Problems Incident to Use of Stop-Transfer Procedures, Current Problems of Securities Underwriters and Dealers*, 18 Bus. Law. 27, 85-89 (1962); § 8-204, Comment 3, where the unexplained suggestion is made that, in the absence of a restrictive legend, the issuer may refuse to register a transfer out of the name of a "control" person, "relying on the stated exception as to a person 'with actual knowledge' of the restriction."

The decision below does not resolve the conflict between the purposes of the Act and the Uniform Commercial Code and ignores the very serious practical reasons why the rule enunciated is not workable. For these reasons, the decision below should be reviewed by this Court.

B. Prior reported decisions bearing on the question presented are conflicting and create a background of legal uncertainty for issuers and transfer agents.

There is, of course, ample support throughout the several states for the proposition that an issuer or transfer agent may, at least temporarily, refuse to register a transfer of securities if the grounds for such refusal are "reasonable". *See generally* 1 F. Christy, *The Transfer of Stock* § 263 (5th ed. 1972); 1 *Loss, supra* at 2657; 18 Am. Jur. 2d *Corporations* § 416 (1965); Uniform Commercial Code § 8-401; *Travis Investment Co. v. Harwyn Publishing Corporation,* 288 F. Supp. 519, 526 (S.D.N.Y. 1968); *Kanton v. United States Plastics, Inc.,* 248 F. Supp. 353, 362-63 (D.N.J. 1965); *Branerton Corporation v. United States Corporation Company,* 34 App. Div. 2d 1, 3, 309 N.Y.S.2d 28, 29 (1970), *motion for leave to appeal dismissed,* 27 N.Y. 2d 722, 262 N.E.2d 670, 314 N.Y.S.2d 529; *Hillary Holding Corporation v. Brooklyn Jockey Club,* 88 N.Y.S.2d 198 (Sup. Ct. 1949). The question which has given rise to so much uncertainty, and which should now be reveiwed by this Court, is whether the fact that a transfer may result in violation of the Act is such a reasonable ground, even where the purchaser has no actual knowledge of any such restriction.

In *Travis Investment Co. v. Harwyn Publishing Corporation,* 288 F. Supp. 519 (S.D.N.Y. 1968), a case which arose before the Uniform Commercial Code became effective in New York but decided under similar propositions of law, the court held that a refusal on the part of an issuer and its transfer agent to register a transfer of securities, pending the receipt of further information as to ownership and control, was reasonable even as against a pledgee which was

arguably in good faith and without notice, where the issuer and transfer agent had been alerted by the Securities and Exchange Commission that stock of the issuer might be sold in the market by persons in a "control" relationship with the issuer. The *Harwyn Publishing* case was followed in *Branerton Corporation v. United States Corporation Company*, 34 App. Div. 2d 1, 309 N.Y.S.2d 28 (1970), a case also involving possible violation of the Act but in connection with securities originally taken "for investment". In *Branerton*, decided under the Uniform Commercial Code, the court reversed an order which had granted the plaintiff, also a pledgee which was arguably in good faith and without notice, summary judgment against a transfer agent for damages for refusal to register a transfer (the issuer having since the commencement of the action gone into Chapter XI proceedings) and remarked:

> "[D]efendant could well have been under a prohibition against transferring the stock. Whether or not plaintiff was aware of the restriction does not appear conclusively, but even if it was not it is not determinative (*Travis Inv. Co.* v. *Harwyn Pub. Corp.*, 288 F. Supp. 519, 526). The issue is whether the transfer agent had reasonable grounds for belief that the transfer would be one forbidden by law. Whether that belief was engendered by a positive statement from the SEC, as in the *Harwyn* case, or came from other sources may go to the weight of the claim that the belief existed, but it certainly does not establish the contrary." 34 App. Div. 2d at 3, 309 N.Y.S.2d at 29-30.

The cases have clearly established that a belief on the part of an issuer or its transfer agent that a transfer may be in violation of the Act must be bona fide and not merely an excuse for a refusal to register a transfer based on other

considerations. *See Kanton v. United States Plastics, Inc.*, 248 F. Supp. 353, 358 (D.N.J. 1965) ("This Court is satisfied that the refusal of both [the transfer agent] and [the issuer] to make the requested transfer of plaintiff's stock was based, not on any fear of criminal sanctions under the Securities Act of 1933, but on orders from [the issuer's president] that the requested transfer was not to be made."); *see also Riskin v. National Computer Analysts, Inc.*, 62 Misc. 2d 605, 308 N.Y.S.2d 985 (Sup. Ct. 1970), *modified*, 37 App. Div. 2d 952, 326 N.Y.S.2d 419 (1971).

To be contrasted with the decisions in *Harwyn Publishing* and *Branerton* is *Welland Investment Corporation v. First National Bank*, 81 N.J. Super. 180, 195 A.2d 210 (Super. Ct. Ch. 1963). In that case, decided under the Uniform Commercial Code, which involved an action brought against an issuer and its transfer agent to compel the transfer of, and for damages for wrongful refusal to transfer, securities originally taken "for investment", the court paid only passing attention to the issuer's stated concern that the requested transfer might violate the Act. The court denied the plaintiff's motion for summary judgment, holding that the sole issue, namely whether the plaintiff, a pledgee, was, in fact, in good faith and without notice, had to await a plenary hearing. *See also Prudential Petroleum Corporation v. Rauscher, Pierce & Co.*, 281 S.W.2d 457 (Tex. Civ. App. 1955), decided under the Uniform Stock Transfer Act; *General Development Corporation v. Catlin*, 139 So. 2d 901 (Fla. Dist. Ct. App. 1962), also decided under the Uniform Stock Transfer Act.

The decision below, avoiding as it does the question which would be presented if Edina had requested injunc-

tive relief directing registration of the transfer, not only does not pay proper heed to the importance of the Act but also does not dispel the existing legal uncertainty surrounding the question presented. For this additional reason, this Court should review the decision below.

C. A restriction imposed by reason of the Securities Act of 1933 should not be construed as a restriction "imposed by the issuer" under Section 8-204 of the Uniform Commercial Code.

The Association submits that the restrictions imposed on securities by the Act, that is, restrictions inhering in "investment" securities or securities held by "control" persons, are restrictions in consequence of substantive federal law. Such restrictions are, therefore, public rather than private in nature and are not, and should not be viewed as, restrictions "imposed by the issuer" within the meaning of Section 8-204.

It is believed that the District Court clearly understood the public nature of the restrictions which inhere in "investment" securities and, in fact, based its decision thereon. At pages 100-01 of the trial transcript, the District Court remarked to counsel for Edina,

> "I must add though why do you say what you do, in effect, that the restriction against transfer was imposed by the issuer rather than to say the restriction on transfer was imposed by the Congress of the United States."

Further, it is believed that the District Court's remarks in its Findings of Fact and Conclusions of Law, Petition for Certiorari at xvi, *Mr. Steak, Inc. v. Edina State Bank*, No. 73-1789 (filed May 29, 1974),

> "We may consider the Uniform Commercial Code in considering the disposition of this case, but insofar as the disposition of this case is governed by the Securities Act of 1933 as amended, the Federal Government has pre-empted the field and to the extent that there is a conflict between the Securities Act of 1933 and the application of the Uniform Commercial Code in the circumstances of this case, it is the Securities Act which will prevail and which the Court will consider."

must be interpreted to illustrate the District Court's view that restrictions which arise by reason of the Act are not privately created under applicable state law but exist as an important part of a broad scheme of federal regulation.

The Official Comment to Section 8-204 demonstrates that the restrictions contemplated by that Section are, in the main, the private restrictions on free transferability traditionally available to issuers, within the limits of applicable state law, for the furtherance of legitimate corporate purposes. Comment 2 indicates, for example:

> "Most jurisdictions recognize the right of issuers to impose restrictions giving either the issuer itself or other stockholders the option to purchase the security at an ascertained price before it is offered to third parties. [citations omitted] This is the type of restriction contemplated by the present section."

And Comment 4 states:

> "This section deals only with restrictions imposed by the issuer and restrictions imposed by statute are not affected." [citations omitted]

While a restrictive legend keyed to the prohibitions of the Act unquestionably would be within Section 8-204, and would, therefore, directly affect the right of a purchaser

under applicable state law to registration of the transfer free of the legend, it must be emphasized that such a restrictive legend should be viewed merely as a device supplementing an issuer's general effort to act in concert with national policy. In the language of Comment 3,

> "[Restrictions on transfer] are being increasingly resorted to today by issuers with publicly held securities seeking to police enforcement of the registration requirements of the Securities Act of 1933 against persons purchasing their securities in a transaction exempt from those requirements ... or against persons in a 'control' relationship to the issuer."

Hence, although the issuer clearly has a private interest in the application of a restrictive legend, the legend is not, in the strict sense, "imposed by the issuer", within the contemplation of Section 8-204. Rather, the restrictive legend is publicly imposed and exists as a creature of statute, not as a creature of private interests.

The Association, therefore, requests this Court to review the decision below, because a proper construction of Section 8-204 in the circumstances of this case is warranted.

Conclusion

The Association strenuously urges this Court to grant the Writ. A decision by this Court will resolve an unfortunate conflict arising under the Act and will foster nationwide uniformity in approach to the questions involved.

The decision below does not resolve such conflict. It will only perpetuate an undesirable and continuing case-by-case analysis on the part of issuers and transfer agents as

to whether, in the particular circumstances, there are not some factual reasons why the issuer or the transfer agent may safely risk a refusal to transfer. Issuers and transfer agents deserve greater guidance in connection with their important responsibilities under the Act. The dilemma, which has been appropriately acknowledged by Professor Loss, 1 *Loss, supra* at 2658,

> "[I]t is not a proposition unique to §5 of the Securities Act that the issuer (or its transfer agent) may in either event guess wrong at the issuer's peril (if not the transfer agent's as well)—whether it improperly registers a transfer or improperly declines to do so."

should not exist.

For all of the foregoing reasons, the Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit should be granted.

Respectfully submitted,

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June 4, 1974

Certificate of Service

I, Arthur H. Christy, one of the attorneys for The Stock Transfer Association, Inc., as amicus curiae herein, and a member of the Bar of the Supreme Court of the United States, hereby certify that, on the 4th day of June, 1974, three true and correct copies of the foregoing Motion and Brief to the Supreme Court of the United States were served on each of the following parties by mailing such copies in duly addressed envelopes, with first-class air-mail postage prepaid, to:

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SUPREME COURT, U. S.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1789

MR. STEAK, INC. and THE CENTRAL BANK AND TRUST COMPANY,

Petitioners,

vs.

EDINA STATE BANK,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTION PRESENTED

It is believed that a more accurate and correct statement of the question presented is as follows:

> Is there a conflict between Section 5 of the Securities Act of 1933, as amended [15 U.S.C. Sec. 77e] and Article 8-204 of the Uniform Commercial Code, and, if so, does said Sec. 5, as applied to the facts of this case, free petitioners from liability under said Article 8-204?

STATEMENT OF THE CASE

The essential facts of this case are without dispute. Unregistered shares were issued by Mr. Steak to one Price who pledged these shares for a loan made to him by Edina, ultimately amounting to $37,000. Upon default by Price, Edina sold 1000 of said shares. Petitioners refused transfer to the purchaser and the sale proceeds were refunded by Edina.

There was no legend or any statement of restriction on the share certificate. Edina had no actual knowledge of a restriction, if any, and was an innocent party as found by the trial court.

ARGUMENT

The Securities Act of 1933, which is administered by the Securities and Exchange Commission having rule making authority, Sec. 19 [15 U.S.C. Sec. 77s] is silent about the notation on a security of a restriction on transfer. Article 8-204 of the UCC, on the other hand, specifically requires such notation and in its absence, renders any restriction ineffective except against a person with actual knowledge. However, the policy which has obtained under the Securities Act, as expressed through releases of the Securities and Exchange Commission [Nos. 33-5121, 17 C.F.R. Secs. 231.5121 and 33-5223, 17 C.F.R. Sec. 231.5226] with respect to the notation on unregistered shares exempt under Section 4(2) of the Securities Act [15 U.S.C. Sec. 77d(2)], is in effect the same as that expressed in the Uniform Commercial Code requirement. There is, therefore, not conflict but harmony between the two legislative enactments. Moreover, on page 10 of their petition, Petitioners specifically state that they do not contend that any such conflict exists.

Petitioners persistently express the concern that compliance with the State Act would cause them to violate the Federal Act and that all issuers and their transfer agents would be in the same predicament. They also urge upon this Court that the question is unique and that the decision of the Court of Appeals will impede "the free flow of securities in the equity markets".

The Petitioners' concern could easily have been eliminated had Mr. Steak taken the initial simple step of noting the share certificate at the time of issue in conformity with the Federal policy expressed in the Securities and Exchange Commission releases and in compliance with the provisions of the Uniform Commercial Code. (Here Mr. Steak had two opportunities—at the time of the original issue of 200 shares to Price and later upon the issue of an additional 2,400 shares pursuant to a 12 to 1 split.) The exemption from registration would have been preserved by the justified refusal to permit an unregistered or unexempted subsequent transfer. Instead, they seem to argue that since they did not protect themselves, any member of the public to whom a legend free "restricted" security is sold or transferred must protect them. There is nothing unique about a question which simply involves the imposition of liability upon a party who has violated a law or who has not taken reasonable steps to protect himself. And there is no equity or justification for shifting the burden of responsibility from a delinquent party, however large or small, to an innocent member of the public.

Fear of sanctions under the Securities Act is more often not bona fide or more fancied than real. Significantly, the instances appear rare when a transfer agent is held liable for registering a transfer. The great preponderance of cases

involve imposition of liability for *refusal* to transfer. For the most part, unlegended securities are usually registered, or if issued in a bona fide private offering have been held for a sufficient period of time to establish investment intent, or if held by control persons, the transfer agent and certainly the issuer are aware of this fact.

The principal responsibility for compliance with state and federal laws is upon the issuer. Since April 15, 1972, this responsibility and the burden and manner of discharging it is made explicit by Rule 144 under the Securities Act of 1933. The issuer must take the necessary steps. If it fails, the transfer agent must disregard its directions to refuse transfer or comply with them and seek reimbursement for any damage suffered. The transfer agent can easily protect itself as to control persons' shares and shares issued prior to registration, as well as to shares issued under exemptions after registration, by requiring initially complete disclosure by the issuer and obtaining an indemnity commitment from it or refuse to act. The real problem is between the issuer and its transfer agent. An innocent member of the public should not suffer because of their delinquencies.

This is the kind of restriction contemplated by the Uniform Commercial Code. It is not statutory. Under Section 4(2) of the Federal Act, an issuer is permitted to issue shares in a bona fide private offering without registration for investment purposes only. Such shares may not be sold without registration until the investment intent is established. (Now to be held for two years under Rule 144 providing other conditions are met.) The issuer, in its own self interest, has the obligation of noting this restriction on the security to protect its claim of exemption by assuring that a purchaser will not distribute before the invest-

ment intent is established. Of course it is also in jeopardy with or without a legend if the issue did not qualify for the exemption in the first instance. In any event, this is not the making of the transfer agent and its compliance with the Uniform Commercial Code discharges its obligations.

It is difficult to conceive a decision more conducive to the free flow of securities than that of the Circuit Court of Appeals which is here criticized by Petitioners. Instead of impeding the flow, it promotes it. As a result of that decision transfer agents can now determine almost routinely whether or not to make a requested transfer. If there is no statement of restriction, they may comply with the request with impunity unless they have otherwise acquired information that the requestor has actual knowledge of a valid unnoted restriction. It is now clear whereas confusion existed before. Achievement of the orderly administration of the security transfer process is now more assured by the decision below.

CONCLUSION

The writ should be denied and the decision of the United States Circuit Court of Appeals should be permitted to stand.

Respectfully submitted,

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